Your Investment Options

A brief overview of different types of investment options.

SAVINGS ACCOUNTS

The rate of return and risk for savings accounts are often lower than for other forms of investment. Savings Accounts are also usually more liquid; you may quickly and easily convert your investments into cash. Interest bearing checking and savings accounts are offered by banks and credit unions. It pays to shop for the best rates, as interest rates, compounding frequency (how often interest is paid), and services vary widely.

If the financial institution is insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration, your account is insured up to $100,000 by the federal government.

CERTIFICATES OF DEPOSIT

Certificates of Deposit or CDs are purchased for specific amounts of money at a fixed interest rate for a specific time. CDs are generally priced in multiples of $1000. Usually, the longer the CD is held, the higher the interest rate. If you cash in the CD before the specified time, you will have to pay a penalty. CDs are also insured (up to $100,000) if the institution is federally insured.

SAVINGS BONDS

Savings bonds are issued by the United States Treasury and come in two varieties. The Series EE and Series HH. EE bonds are available at most banks. The minimum purchase is a $25 bond which will mature to pay $50 in eight to 12 years depending on the interest rate. The interest rate on the bond is related to the market interest rate and there is a penalty for cashing a bond in early. Series HH bonds are purchased from a Federal Reserve Bank or through the Treasury at face value. They can be bought only by trading in EE bonds or an old H bond. The HH bond matures in 10 years with interest paid semi-annually.

Treasury Bonds are considered the safest bond investment. They are not insured but are backed by the full faith and credit of the United States government. The US guarantees that the investor will receive full principal amount upon maturity. There are no sales charges for Treasury bonds and the interest they earn is exempt from state and local taxes and can be deferred from federal income tax until the money is received.

GOVERNMENT SECURITIES

The United States government also issues debt securities to raise funds. Other US securities (besides the savings bonds) include Treasury Bills (Tbills) with up to one year maturities, Treasury Notes with up to 10 year maturities, and other United States Agency bonds. T-bills are sold to selected securities dealers by the Treasury at auction. Investors can buy all three types, without paying commission, directly from a Federal Reserve Bank, or from a dealer.

OTHER BONDS

Municipal Bonds are issued by states, cities, or certain local government agencies. An important feature of these bonds is that the interest which a bondholder receives is not subject to federal income tax. Also the interest is exempt from state and local tax if the bondholder lives in the jurisdiction of the issuer. Because of these tax advantages the interest rate is usually lower than that paid on corporate bonds Municipal bonds are issued to fund needed projects; such as bridges, schools, and new roads.

Corporate Bonds usually pay higher interest than government bonds but they are somewhat riskier. If a corporation goes bankrupt, bondholders, as creditors, are paid their money before stockholders. Corporate bonds are either secured or unsecured. A secured bond is backed by specified assets or collateral, while an unsecured bond is backed only by the faith and credit of the corporation. Companies offering bonds to the public must file a registration statement with the SEC.

Why Bonds are resold on the market: Why would someone want to sell a $1,000 bond for less than its full value? Suppose you buy a bond for $1,000 that pays 10% interest and matures in ten years. Each year you would receive $100. After a few years, lets say interest rates in general rise to $15. Your $1000 investment could be paying $150 a year. You want to sell the bond to reinvest as much of the $1000 as you can, but who wants to pay $1000 for a bond only paying $100 a year when they could pay $1,000 for a bond paying $150 a year. To sell your bond you have to discount its price. On the other hand, if interest rates fall you would be able to sell it for more than $1,000.

"Junk Bond" is a term for speculative, high-risk, high interest rate corporate or municipal bonds. The default rate is much higher on junk bonds than on higher quality bonds.

STOCKS

As already discussed, when you buy stock, you are becoming an owner of the company. If the company does well, the value of your stock should go up over time. If the company does not do well, the value of your investment will decrease. Many companies distribute a portion of their profits to shareholders as dividends. As owners, shareholders generally have the right to vote on electing the board of directors and on certain other matters of particular significance to the company.

Companies issue two types of stock, common and preferred. Common stock is the basic form of ownership in a company. People who hold common stock have a claim on the assets and earnings of a firm after the claims of preferred stockholders and bondholders. The safety of the principal of preferred stock is greater than that of common stock, however, preferred stockholders cannot vote for the directors of the company.

There are five basic categories of stock:

- ✓ *"Income stocks"* pay unusually large dividends that can be used as a means of generating income without selling the stock. Most utility stocks are considered income stocks

- ✓ *"Blue chip stocks"* are issued by very solid and reliable companies with long histories of consistent growth and stability. Blue chip stocks usually pay small but regular dividends and maintain a fairly steady price. Examples of Blue chip stocks include IBM, Exxon, Kodak, GE, and Sears.

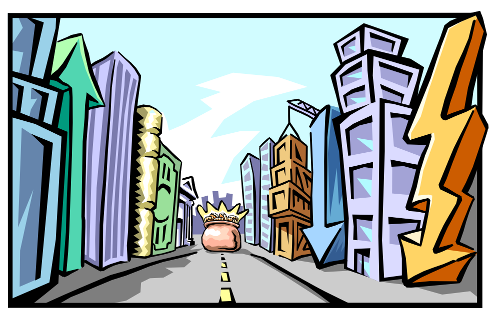
- ✓ *"Growth stocks"* are issued by young, entrepreneurial companies that are experiencing a faster rate of growth than their general industry. Their stocks normally pay little or no dividend because the company needs all of its earning to finance expansion. Since they are issued by new companies, with no track record, growth stocks are riskier but offer more potential for growth than other kinds of stock.

- ✓ *"Cyclical stocks"* are issued by companies that are affected by general economic treads. The prices of these stocks tend to go down during recessionary periods and increase during economic booms. Cyclical stocks include automobiles, heavy machinery, and home building.

- ✓ *"Defensive stocks"* are the opposite of cyclical stock. They are issued by companies producing staples such as food, beverages, drugs and insurance and they usually maintain their value.

STOCK SPLITS

When a company increase the amount of its shares it is said to split. A 2 for 1 split means that the company has doubled the amount of outstanding shares. The sale price will decrease proportionally to the split so if a stock holder held 100 share of stock for $40 per share, after the spit she would have 200 shares at $20 a share. The stockholder's equity remains the same. The stock split in intended to reward shareholders. By making the company's stock less expensive, it is hoped to attract more investment, thus leading to an increase in the price of its stock.



MUTUAL FUNDS

A mutual fund invests the pooled money of its shareholders in various types of investments. A fund manager buys and sells securities for the fund's shareholders. Mutual fund values rise and fall along with the securities in the fund. An investor may prefer to invest in mutual funds for diversification, to take advantage of the professional management, the low cost of shares, or the ease with an investor can buy and sell shares. Each mutual fund has an objective which determines the types of securities it invests in. The fund's objectives must be stated clearly in the prospectus. More than 6,000 mutual funds are available, all with different objectives, securities owned, levels of risk, and levels of earnings.

All mutual funds have management fees and some have additional fees when shares are bought and sold. The prospectus must disclose all fees and costs. Many mutual funds are part of a family of funds (i.e. issued by the same mutual company). A financial service company may offer a number of funds with different objectives and the investor may switch from one fund to another within the same family at little or no expense.

FUTURES

A futures contract is a commitment to buy or sell a specific amount of a commodity at a specific future date and price.

DERIVATIVES

Stock options are known as derivative investment instruments because their value derives from the security on which they are based. Stock options are contracts giving the purchaser the right to buy or sell a stock at a specific price within a certain period of time. Like all futures contracts a stock option can be a very complicated and risky investment.

LAND

The most common investment people hold is real estate (in the form of home ownership). Over two-thirds of American's own their homes. Generally, home ownership is a good investment, as real estate prices generally rise. However, as the purchase of a home is usually the largest single investment a person makes, if real estate prices fall owners may have a hard time keeping up with their mortgages.

TANGIBLE ASSETS

Assets that you can hold onto or touch are called tangible. They include gold coins, and other collectible items like dolls, baseball cards, or stamps. Generally collectibles pay no interest and may or may not increase in value over the years. There is no regulated market for collectibles and should be used for enjoyment rather than investment.

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